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Henry Review – Small Business Factors

The Government has released the Henry Committee's report that contains 138 recommendations for changes to our Tax System. The proposals that apply to small business include:

1. Company Income Tax Rate

The company income tax rate should be reduced to 25%. The Government has proposed the company tax rate be reduced as follows:

	Small Business	Other
2011-12	30%	30%
2012-13	28%	30%
2013-14	28%	29%
2014-15	28%	28%

2. Capital Allowances

(a) depreciating assets costing less than \$5,000 to be immediately written-off. The Government has announced it will allow a write off for assets costing less than \$5,000 from 1 July 2012; and
(b) all other depreciating assets valued at \$5,000 or more (except buildings) to be pooled (the Government has accepted a single pool with a 30% DV rate from 1 July 2012).

3. Increase to Small Business Threshold

The small business entity turnover threshold should be increased from \$2 million to \$5 million, and adjustments to the \$6 million net asset value test should be considered. The Government has not commented on this.

4. Carry back Losses

Companies should be allowed to carry back a revenue loss to offset it against the prior year's taxable income. The Government has not commented on this.

5. Trust rules to be rewritten

The current trust rules should be updated and rewritten to reduce complexity and uncertainty around their application. The Government has not commented on this.

6. Introduce flow through taxation for closely held companies

A flow-through entity regime for closely held companies and fixed trusts should be considered in the future. The Government has not commented on this.

7. Amend tax arrangements for clubs

Simple tax arrangements should be established for clubs with large trading activities in the fields of gaming, catering, entertainment and hospitality. This has been rejected by the Government.

8. Amendments to Fringe Benefits Tax

Fringe benefits that are readily valued and attributable to individual employees should be taxed in the hands of employees through the PAYG system. Other benefits, including those incidental to an individual's employment, should remain taxed to employers at the top marginal rate. In addition, the formula for valuing car fringe benefits should be replaced with a single statutory rate of 20%, regardless of the kilometres travelled. The Government has not commented on these recommendations.

9. Rationalising and streamlining the current small business capital gains tax concessions by:

- removing the active asset 50% reduction and 15- year exemption concessions;
- increasing the retirement exemption by aligning it with the cap for contributions to a super fund; and
- allowing taxpayers who sell a share in a company or an interest in a trust to access the concessions via the turnover test.

The Government has not commented on these.

10. Removing the pre-CGT status of assets acquired before 19 September 1985 – This has been rejected by the Government.



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Trust Streaming in Doubt

Amounts Assessed to Beneficiaries

The ATO states that the amount included in a beneficiary's assessable income from the trust distribution consists of an undissected proportionate share of the entirety of the taxable net income.

This means, for example, if a beneficiary is entitled to receive all the interest income of a trust, which consists of 30% of the distributable income of the trust, the beneficiary will be assessed on 30% of all the different classes of income derived by the trust for tax purposes. That is, they will be assessed on 30% of the interest income, as well as 30% of any other taxable income such as dividends, capital gains etc. If this is correct, this means that streaming of different classes of income would not be tax effective (see below).

Streaming and Capital Gains

The Commissioner has foreshadowed changes will be made to the following:

- **Capital gain streaming** – Effective from 1 July 2010, the Commissioner will withdraw PS LA 2005/1 (GA) which allowed the streaming of capital gains to beneficiaries. This Practice Statement will still be valid for trust capital gains prior to 1 July 2010, unless there is a dispute in which case the Commissioner will apply the ATO view of the law.

- **Franking credit streaming** – The current ruling on franking credit streaming (TR 92/13) will be withdrawn effective from 1 July 2010. Taxpayers may rely on TR 92/13 until 30 June 2010 and earlier income years.

What is Income or Capital of a Trust?

The Commissioner now accepts 'income of the trust estate' takes its meaning from general trust law concepts. For practical purposes, this means the trust deed can define the meaning of distributable income of the trust.

What Action Should Be Taken Now?

The decision highlights the importance of having a relevant and up to date definition of income in the trust deed. For example, does your trust deed:

- Have a definition of income that includes taxable capital gains;
- Provides the ability for the trustee to define capital gains as income (this is particularly important for deeds drafted before CGT was introduced); or
- Defines income of the trust to be the same as net income under section 97 of the ITAA 1936?

When drafting trust distribution minutes, you should ensure they comply with the terms of the deed. For example, if the trust deed defines income to be the same as section 97 net income, the accounts of the trust and the distribution minutes should be based on the taxable income of the trust and not based on accounting principles.

There are unresolved issues for trust distributions but we will keep you informed of developments.

Superannuation Focus – The Cooper Review

Superannuation Review

Having reformed the tax system and the financial advisory industry, the Federal Government has now turned its attention to Australia's Superannuation Industry with the release of the Cooper Report. The Cooper Review was engaged by the Government to review the superannuation industry with the aim of making superannuation simpler, safer and more efficient. The emphasis of the review is on reducing costs and increasing retirement benefits to members.

The Cooper Report makes a number of significant recommendations to reform Australian superannuation, with many of



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the recommendations being welcomed by the Government and industry groups. The key recommendations are designed to drive mergers within the industry to increase efficiencies, reduce costs and increase performance (as a target, to reduce the current 270 retail and industry funds to a range of 20 to 70). The Minister for Superannuation, Chris Bowen, announced the Government will respond to the Report within 4-8 weeks.

My Super – A new default fund

One of the key initiatives of the Cooper Report is the recommendation for existing funds to establish a default fund, referred to as My Super. The review committee recognised that a significant majority of Australians do not engage with their superannuation because they are either too young, lack the necessary financial knowledge to determine how to invest their funds, or simply because they are not interested.

To address this, the Committee recommended My Super as a default option for all existing funds. It has been described as a simple, cost effective product where the trustee will be made responsible for making the investment decisions on behalf of the members.

The Report does not dictate what form this investment strategy should take. Rather, it stresses the investment strategy must be designed to maximise the returns to members. The Report recognises the lowest cost strategy may not be the optimal decision, and it provides for flexibility in trustees selecting the optimal investment strategy as a static strategy may not prove optimal in changing economic conditions.

Importantly, the Report recommends that no commissions be paid to advisers from these accounts. The Committee cites the My Super default fund will provide for lower fees to members, greater retirement benefits, greater efficiency and enhanced security for members.

SuperStream

Another key initiative of the Report is the recommendation for SuperStream. The Committee recognised there were significant inefficiencies in the industry through a lack of industry data standards, the lack of a single means to identify members, no continuity across funds and their data management, and no consistency of processes.

To counter these, the Committee has recommended SuperStream, which is aimed at establishing this much needed consistency, which should result in lower fees for members. SuperStream encompasses three separate initiatives:

- The use of technology and uniform data standards
- Electronic contributions and submission of data from employers
- Using the tax file numbers of members as the uniform method of identification.

The primary target of SuperStream appears to be employers, who would be required to provide the tax file numbers of their employee members, and a requirement that all transactions (including contributions and data transfer) be done electronically.

Self Managed Super Funds (SMSF)

Overall, the Committee recognised that SMSFs are the right vehicle for individuals who wanted to control their superannuation, retirement savings and investments. Notwithstanding, the Report makes a number of recommendations regarding the SMSF sector:

- *Borrowing* – the Committee noted that fund borrowing requirements are currently in a state of flux with the legislative changes in 2007 and additional safeguards to be introduced by the Government. To that end, the Committee recommends that a review of fund borrowing patterns be undertaken in two years time (allowing the changes to become bedded down) to ensure



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funds are not be abused through relaxed borrowing rules

- **Assets** – the Committee made several recommendations regarding assets:
 - The 5% in house asset rule be repealed, with funds prohibited from holding in house asset investments

- A 5 year transitional period be introduced to allow funds to liquidate their current in house asset holdings – no new in house asset investments would be permitted in the transitional period

- For non arm's length transactions, they should be conducted at market value. Market value would be determined through the price established in an active market, or in the absence of this price, through a valuation from a qualified, independent valuer

- Investment in collectables and personal use assets is to be prohibited. A 5 year transitional period is to be introduced to allow funds to liquidate these assets

- **Compliance** – a number of compliance recommendations were also made:

- Auditors should be registered as approved auditors with ASIC

- ASIC is to set competency and independency requirements

- The Tax Office and ASIC be empowered to impose financial penalties on trustees, advisers and auditors for breaches of prudential requirements

- Advisers, including accountants, should be licensed if they are establishing SMSF on behalf of clients

Other recommendations

The Committee, amongst its raft of recommendations, made the following which should be of interest:

- Binding death nominations should be reviewed every 5 years

- Binding death nominations can be declared invalid if the circumstances of the deceased member have changed

- Greater restrictions on commissions and fees

- Increased prudential reserves to be held by trustees of larger funds

- A requirement for trustees to hold greater qualifications and a requirement for a small number of directors of trustee companies to be independent

- A requirement for fund managers to disclose terms, conditions and fees on their website

- A requirement for trustees to indicate how they voted at company meetings.

The Government appears to favour many of the initiatives of the Committee. However, until the final response is made, it is difficult to determine how many of these recommendations will proceed (especially given the lukewarm follow up to the Henry Review). In addition, the response may get buried in the election campaign. Overall, many of the recommendations have merit, so we can but sit and wait to see how many of these recommendations proceed.

Contact Us

For much more information about these recent tax changes or for advice regarding your personal situation please contact us.